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Rationale: The Foreclosure Doctrine

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THE RATIONALE BEHIND THE FORECLOSURE DOCTRINE

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The last four years have been busy years in shaping the future of antitrust. Beginning with *Brown Shoe Co. v. United States*,[1] the Supreme Court has continually followed a policy of denying the right of viable companies to merge either vertically or horizontally. In line with these decisions, the Court has been forced to consider the effects of other forms of integration, such as exclusive dealing, joint venture and franchise, that might accomplish the same effect as the merger. On the other hand, the Court has been required to recognize that some forms of integration are helpful and useful to a competitive economy. Nevertheless, these cases have developed into a pattern which may become an effective check on both the growth of oligopoly and the exploitation of its potential.

The *Brown Shoe* case itself is interesting in that it involves one of the less concentrated industries in the United States.[2] As the Court pointed out, the top four companies after the Kinney merger produced twenty-three per cent of the nation's shoes, while the largest twenty-four manufacturers produced about thirty-five per cent of the nation's shoes.[3] The Court did not hold that the merger of the manufacturing facilities was illegal. It held that the vertical merger of a large retailer with an integrated manufacturer and retailer is illegal. The Court carefully pointed out that the Clayton Act was directed only at members of an oligopoly when it said: "Similarly, Congress foresaw that the merger of two large companies or a large and a small company might violate the Clayton Act while the merger of two small companies might not, although the share of the market foreclosed be identical, if the purpose of the small companies is to enable them in combination to compete with larger corporations dominating the market."[4]

The basis of this whole opinion lies in its attack on incipiency and market trends and not in the least on existing market power.

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1 370 U.S. 294 (1962).

2 J. BAIN, BARRIERS TO NEW COMPETITION, 45 (1956).

3 Brown Shoe Co. v. United States, 370 U.S. 294, 300 (1962).

4 *Id.* at 331.

Under no stretch of the imagination could one conceive that after the merger Brown Shoe could, on its own, affect either the total production of shoes or the general price level of shoes. Why then did the Court act? Is there any justification for stopping a trend in its incipiency when it may die before it has had an appreciable market effect?

In the following statement, the Court seems to say that the purpose is to protect the small businessman:

> Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.[5]

This desire to protect small retailers is of small import to the Court and in fact such protection probably could not and would not be accomplished by the decision in *Brown Shoe*. The decision basically stops the purchase of chains of retailers by manufacturers and is aimed at foreclosure of the manufacturers' market. Thus if the decision in the case grants any benefit, the benefit will go to the other manufacturers and not to the small retailer.

Before we can tell if the Court's decision has any merit, we must decide what, for the members of the industry, are the advantages that lie in the direction that the Brown Shoe Company was moving. If the only advantages were those mentioned in the opinion, *e.g.*, "The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at price below those of competing independent retailers,"[6] then there would be no reason for preventing the public from receiving the advantages of such a distribution system. The benefit to Brown Shoe and other integrated manufacturers, however, must lie in another area, or the opinion which prevents the integration is wrong. What benefit is there to a shoe manufacturer to integrate vertically? If no one else does so, and if the manufacturer has a small percentage of the market, then the only advantages are those which involve possible savings in handling. Such savings are unlikely, however, because shoe jobbing is competitive and, therefore,

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[5] *Id.* at 344.

[6] *Id.*

there would be no monopoly or oligopoly profits to cut into. The advantages must lie elsewhere.

Let us assume that the trend stopped or slowed by the *Brown Shoe* decision had continued. Assume further that the major shoe manufacturers had vertically integrated and that they had captured a somewhat larger proportion of the market. What would be the result? The vertical integration would permit extensive use of both local and national advertising of shoes.[7] Through advertising, the major companies could begin, in the mind of the consumer, to differentiate their shoes from other shoes. The manufacturers could then receive whatever profits would arise from that differentiation. In addition, through vertical integration there would be very little leakage from the advertising.[8] If a consumer goes to a shoe store that sells a full line of shoes, he can easily be persuaded by the salesman to buy any brand. On the other hand, if he goes to a vertically integrated shoe store, he has to buy the brand of shoe sold there. Locally, the vertically integrated shoe store can by its very presence be used to reinforce the national advertising. What, then, is wrong with this development if a reasonable number of manufacturers still exist and compete under this system? To fully answer this question, we must consider the full results of this trend against the present organization of the industry and determine whether such a system would be beneficial or detrimental to the consumers of the society in general.

If national advertising, coupled with vertical integration, is a successful business practice, then the capital requirements for a firm to stay or to enter the shoe industry are increased enormously. Clearly, an industry organized in such a fashion could not support a great number of firms, since such advertising and vertical integration would become too costly unless they were spread over a large volume. During the period of transition from competitive to oligopolistic structure, the advantages would lie with the firms in the best capital position and the ones who had already begun to integrate. One might ask why firms would decide to engage in vertical integration and national advertising if there were added costs. First, if the firm were successful in differentiating its product, the final result would allow the firm long-term oligopoly profits and, secondly, the very fact that it could successfully raise the scale of operations would increase the stability of its oligopoly gains. The better capitalized firms have everything to gain by the

[7] Bork, *The Rule of Reason: Ancillary Restraints and the Per Se Rule*, 75 YALE L. J. 373, 429, 451 (1966). Here, Bork discusses the advantages of vertical integration in fostering a selling effort.

[8] *Id.*

switch to vertical integration and national advertising. As the cost of competing for a share of the market rises, only firms that can operate on a national scale and have assured outlets can spread the cost of advertising over enough units.[9] Thus, if the trend persists, more and more retail chains and manufacturers will be required to merge, to compete, or to sell out in order to limit their losses. When the industry is reduced to the normal oligopoly form with three or four firms holding seventy-five per cent of the market, a new stability will arrive. Some small firms will remain because they satisfy specialized segments of the market. The general price of the product will be higher than before, first, because of the cost of product differentiation, and secondly, because entry on the appropriate scale would cost the entering firm more than it could eventually recover. The reasons that the new firm could not recover its cost are as follows: (1) the new firm must raise money for plant, equipment, and for vertically integrated stores; (2) the new firm must acquire enough volume to pay for national advertising; (3) the new firm must advertise sufficiently so that consumers will leave known brands and switch to his brand;[10] (4) the new firm probably will not use price cutting because a new firm would easily be matched by existing firms, and when so matched, price-cutting would not increase the new firm's volume but would reduce its revenue.[11]

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[9] Most advertising must be on a large scale. If you wish to advertise in a national magazine or on national television you must buy an audience of 4 or 40 million, as the case may be. You cannot buy smaller audiences to fit smaller production, and therefore you must be able to produce a large amount of goods to use these media.

[10] J. BAIN, *supra* note 2, at 116. "Thus a general tendency of buyers to prefer the established firms. Thus a general tendency of buyers to prefer established to new products may place potential entrants to a differentiated-product industry at a disadvantage as compared to firms already established in the industry." *Id.*

[11] M. SHUBIK, STRATEGY AND MARKET STRUCTURE, 251-52 (1959).

"In a market in which there is a combination of some or all of these features, few competitors, high overhead costs, high entry costs, limited flexibility of short-run production rates (possibly job shop production), high inventory charges, relatively inelastic demand for the products of the firms as a group, relatively high cross-elasticity of demand between similar products of different firms, open information on prices, technical difficulties in spreading information about frequent price changes (catalogues for instance), or consumer resistance to recurrent price adjustments, it is plausible to expect that any perceptible price cut by one firm will at least be met by its competitors. If it is more profitable for a firm to meet an opponent's price reduction than to maintain a higher price, the reduction will at least be met. In general, with the foregoing qualifications as to the type of market, this will hold true.

If we consider price competition, then *ceteris paribus* almost any

Under such circumstances a new firm would expect to suffer losses for a number of years before becoming established. Whatever the initial investment, no return could be expected for some time. Thus, if interest rates were six per cent and losses were expected for four years, the return after successful entry would have to be exceedingly high in order to elicit investment of present capital in expectation of income that would begin four years later.[12]

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price that is not too high to cause new entry will be a potential equilibrium price. The mere threat of each firm to meet a price cut is sufficient. A plausible threat strategy that we may assume would be employed by each firm can be expressed as follows:

> I will maintain the statutory price if I observe that my opponent has done so; if he cuts price, I will meet the cut; if he raises price, then, depending upon my analysis of market cross-elasticities, I may follow him.

The only violation short of total war that should be attempted against such a strategy is an upward testing of the market.

Ceteris paribus (i.e., leaving out advertising, plant expansion, styling, etc.), aluminum, steel, automobiles, rayon, and other heavy manufacturing fit closely into this pattern of price competition. We see that in markets of this structure we may expect similar prices and even upward movements *without* there being any explicit communication between firms or any collusive intent. It is almost meaningless to talk about collusive price behavior in such a market because the structure implies that almost any price level within a range can be enforced as a non-co-operative equilibrium under very plausible assumptions concerning an opponent's threat." *Id.*

[12] M. SHUBIK, *supra* note 2, at 260-64.

"The model to be examined is a very simplified one-person game of economic survival applied to a problem of entry and investment. We describe the game with the following notation:

$$X, 0, 0, \infty, \rho, A_1, \begin{pmatrix} -1 & 1 \\ 1 & -1 \end{pmatrix}, (p, 1-p).$$

The X is the amount of money in the firm's investment account, the first 0 indicates that there is no money in the corporate account. The 0 and the ∞ are used to indicate that the player's opponent is nature, who has 0 in her investment account and infinite resources in her corporate account. The A_1 indicates the prize to the player if he loses (he never wins in the sense that he remains the only survivor because he can never ruin nature).

The market matrix and the strategy of nature are given. With all this information, the problem that remains is more closely related to probability theory than to game theory. However, it is a degenerate form of game that is of economic interest.

As before, ρ is the discount rate. Furthermore, we assume that if the firm enters the market, it will be forced out if its corporate account reaches the size K where $K < X$. If a firm is ruined or otherwise liquidates, the "prize" $A_1 = -K$; in other words, if a firm leaves the market, its liquidation losses are K (in the simplest example we assume $K = 0$).

Suppose that a group of individuals with resources X wished to enter the market with the object of maximizing the size of the expected discounted income paid into the withdrawal account of their firm.

We can see immediately that they will not enter if $p = q = \frac{1}{2}$. We assume that $p > \frac{1}{2}$. It is also evident that there will be no incentive to enter if the discount rate is greater than the expected gain in a single period. For instance, if the expected gain from the investment of a unit is 0.05 in one period and the discount rate is greater than 0.05, there is no incentive to invest. Let $v(X)$ represent the expected value of entering into the market with initial assets of X. Suppose that the group adopted the following financial strategy: If it entered the market, then it would plow back all earnings into the firm until a certain safety level Z had been established. Any amount above Z would be paid out in dividends. The proof that this is the optimal policy for the firm is given elsewhere. The group wished to determine the optimal value for the number Z and then to determine the value of entering $v(X)$ if they adopted their optimal financial policy. We can portray the problem by this set of equations:

(1) $v(X) = \rho p v(X + 1) + \rho q v(X - 1)$ for $X < Z$

(2) $v(0) = 0$

(3) $v(Z + 1) = v(Z) + 1$

Equation 1 establishes a relation between the value of the position of the firm at a given time t and the discounted value of the firm one period later if it enters the market. It states that the value of the firm at time t equals the expected discounted value of the firm in one period later, after it has made a profit, plus the expected discounted value of the firm after it has made a loss. Equation 2 states that the value of the firm when it has no assets is zero (this is a special case in which $K = 0$). Equation 3 specifies the boundary condition at which the firm begins to pay dividends. The value of the firm, when it is operating under the rule that it pays dividends if it makes a profit, equals the expected discounted value of the firm with less assets caused by taking a loss, plus the expected discounted value of the firm with the same assets as previously, plus the expected discounted value of the dividends.

In order to solve the difference equation 1 we set

$$v(X) = a^X.$$

Equation 1 becomes

$$\rho p a^{X+1} - a^X + \rho q a^{X-1} = 0,$$

hence

$$\rho p a^2 - a + \rho q = 0,$$

and

$$a = \frac{1 \pm \sqrt{1 - 4\rho^2 pq}}{2\rho p};$$

denoting the roots by a_1 and a_2,

$$v(X) = A_1 a_1^X + A_2 a_2^X.$$

From (2) and (3) we obtain

$$A_1 = -A_2$$

and

$$A_1 = \frac{1}{(a_1^{Z+1} - a_2^{Z+1}) - (a_1^Z - a_2^Z)}$$

The value of the investment to the firm is a function of both X and Z, so we can express it as

(4) $$v(X, Z) = A_1(Z)\{a_1^X - a_2^X\}.$$

If we restrict payments to integral quantities, then we can calculate

$v(X, Z)$ for different assets, policies, and probabilities directly by machine using equation 4.

Table 16

$\rho = 0.7$, $\dot{p} = 0.99$

X \ Z	1	2	3
1	[2.26]	1.59	1.10
2		2.29	1.60
3			2.29

$\rho = 0.995$, $\dot{p} = 0.99$

X \ Z	2	3	4
1	191.34	195.08	195.08
2	194.21	198.02	198.02
3		199.04	[199.04]

$\rho = 0.99$, $\dot{p} = 0.55$

X \ Z	7	8
1	1.95	1.93
2	3.57	3.55
3	4.97	4.94
4	6.20	6.16
5	7.33	7.27
6	8.38	8.32
7	[9.39]	9.32
8		10.31
9		
10		

$\rho = 0.995$, $\dot{p} = 0.55$

X \ Z	7	8	9	10
1	2.66	2.84	2.97	3.06
2	4.86	5.18	5.42	5.59
3	6.71	7.19	7.48	7.71
4	8.82	8.83	9.24	9.52
5	9.65	10.28	10.75	11.09
6	10.85	11.57	12.10	12.47
7	11.94	12.73	13.32	13.72
8		13.80	14.43	14.87
9			15.48	15.95
10				[16.98]

Several values are given in Table 16:

The numbers in boxes represent the values of the largest investment that will be made under the appropriate optimal policy. We note that in each case the incremental value of an extra unit invested drops until it yields a return of less than a unit. The optimal amount called for by the optimal policy is determined by the point at which the increment of capital added has the same value as its cost. For example, we note that when $\rho = 0.995$ and $\rho = 0.99$, under the policy $Z = 3$, the value added by increasing investment from $X = 2$ to $X = 3$ is $194.99 — 193.99 = 1$.

In general, the optimum policies call for small values for Z. Only if there is a very low discount rate and a small favorable bias in the odds, will Z become large.

The withdrawal policy depends upon the discount rate, the probability of success, and the size of the liquidation loss. In the example calculated we simplified the calculations by assuming that there was no liquidation loss. Thus we used equation 2, $v(0) = 0$. If we wish to examine how the size of liquidation losses effect the solution we must solve the system using equation:

(2') $v(K_2 = 0.$

This indicates that as soon as the firm's assets fall to K it is ruined and loses these assets. When there is no liquidation loss and the probability of gain is greater than the discount factor it will always pay a firm interested in maximizing expected discounted income to enter the market. This will not be true when there is a liquidation cost.

The analysis used was based on the assumption that the firm wished to maximize the expected discounted value of funds withdrawn from the corporation. Suppose, instead, that the investing firm were

And clearly, the investor could not know whether he would ever successfully enter. If the existing firms were strong, they would consider whether to cut prices, increase advertising, etc., to stop the entry. If they believed that within a reasonable time they could stop the entry successfully, then it would be to their advantage to do so.[13] If on the other hand the new entrant could show that nothing would daunt him, it is probable that the existing firms would react only to aggressive moves by the entrant.[14] Under such circumstances, however, it is unlikely that a new entrant would raise the capital to make an entry, for the amount of capital necessary to do so would in most cases be either greater than the amount necessary to buy out an existing competitor or to obtain an equal return in another field.

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a corporation controlled by officers whose fortunes are linked to the assets as well as the earnings of their corporation. If they are forced to pay out to the stockholders at least as much as q/p of any unit earned, there will be no incentive for the directors to invest because it is certain that eventually the investment will be lost and the total assets of the corporation diminished, even though the stockholders may have benefited.

. . . .

The type of problem posed by a one-person game of economic survival is closely related to problems in dynamic programming and inventory theory and involves the study of the theory of random walks (footnotes omitted)." *Id.*

[13] M. SHUBIK, *supra* note 2, at 264.

"The formula in equation 4 depends upon four financial features: the rate of discount, the liquidation conditions for the firm, the size of the initial investment funds available, and the disbursement policy adopted by the entrant.

We note that as the initial assets of the entering firm are raised, i.e., X becomes larger, the value of entering becomes greater. In other words, the value of a firm is a function of the amount of money possessed by the individuals who buy it. The meaning of this becomes more evident when we examine entry into an oligopolistic market. Suppose an individual were offered an industrial plant for a sum that tied up almost all the money that his financial group could obtain credit lines for. Given a weak capitalization the other firms might be able to wipe out the entrant within a brief period and more than recoup their battle losses as compared with the loss they would otherwise suffer through sharing the market. In this case the firm is not worth its price to the prospective purchaser. Suppose now that the price of the firm were still the same but that the purchasing group controlled larger resources than before. The time it would take the others to drive the entrant out and the losses incurred in doing so might make it more economical to allow the newcomer to take a share of the market without resorting to destructive tactics. The mere presence of the entrant's extra reserves could be sufficient to change a poor buy into a worthwhile investment." *Id.*

[14] *Id.*

Another circumstance exists to prevent entry. Assume that the volume of the market cannot support more than four firms which are vertically integrated and which use national advertising. In such a situation the new firm must expect that its entry will be strongly resisted. Under such circumstances new investors who lack "sunk costs" would be foolish to try to enter, even though the return for the existing firms is greater than the general level of return for investments.

We have stated that the cost of entry under such circumstances is much greater than the cost of buying an existing firm and, therefore, no entry should be expected. One could assume that if this were true, then the purchase price of an existing firm would rise until the price was equal to the cost of a new entry. This is not true, for a new entry into an oligopolistically organized industry which has product differentiation may impose losses or smaller profits on all parties. Such losses do not occur if entry is by merger or purchase. No loss occurs during the time the product is established. And there is no general loss to the whole industry because existing firms do not have to adjust their prices and production to accomodate the new firm. When entry is by merger there is little possibility of a loss caused by overproduction. On the other hand, a new entrant might force the whole industry into producing more goods and thereby driving the price below the industry's marginal revenue. Such an occurrence is a distinct possibility, if we assume that prior to the entry of a new firm the existing firms had adjusted their production so that price equalled marginal revenue. Under such circumstances it is clear that the cost of a new large-scale entry could not be computed.[15] The price of existing firms can, however, be calculated by discounting their future income stream at an appropriate rate of interest.[16] In a competitive market, on the other hand, the price of an existing firm would not be greater than the cost of its replacement. Therefore, capital would move into the industry whenever the return for the industry increased over the normal rate of return for capital, and it would continue to move into the industry until the rate of return in the industry equalled the rate of return available in other industries.

Assuming that the shoe industry is now a competitive indus-

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[15] See generally M. Shubik, *supra* note 2, at ch. 10. Shubik points out that numerous strategies are available to the existing firms depending on their judgment of the vulnerability of the new entrants to attach and the cost to the industry in engaging in these strategies.

[16] Seligman, *Why the Stock Market Acts that Way*, FORTUNE, Nov. 1966, at 154.

try, we find that when the demand for shoes shifts so that the existing firms make a greater than normal return, there is an immediate influx of capital into the industry. The costs in the new firms would be no greater than in the existing firms. Conversely, if we assume that the shoe industry is organized oligopolistically and entry into the industry is made only on a scale that would justify national advertising and vertical integration, then no entry could be made unless the shift in the demand for shoes were so great that the entry could be made on that scale without disrupting the existing firms. Certainly the conditions for successful entry in a oligopolistically organized industry would not exist merely because the rate of return in the industry was greater than the rate generally available or because the price of the product was above its marginal cost. The conditions for entry require an unusual demand situation wherein the existing firms cannot meet that unusual demand even though the consumers wish to patronize the existing firms. Under such circumstances, existing firms could not retaliate against a new entrant. Conditions of this sort existed in the auto industry for a short time immediately after World War II. Under those conditions Kaiser Motors was able to enter the market. But when normal consumer preferences could operate, then the new firm was unable to stay in business.

If it is true that vertical integration together with national advertising leading to market differentiation of the product is an effective barrier to entry and results in an oligopolistic organization of industry, does it follow that such an organization of industry should be deterred or prevented by law?

One may argue that industry is organized in this fashion because consumers want it that way. The logic of the argument is that if consumers prefer lower prices to national advertising, vertical integration, and product differentiation, they would buy from companies that produce lower priced goods as opposed to nationally advertised goods. Thus one admits that if it is impossible to sell both nationally advertised and lower-priced goods simultaneously, then industry will produce what the majority of the consumers "prefer." But if the consumer prefers higher prices and product differentiation, he should be allowed to have it.[17] The validity of

[17] Bork, *supra* note 7, at 473.

"The contention that consumers rather than producers should determine whether lower prices or other inducements are offered constitutes a fundamental misperception of the issue. In the case of all ancillary restraints whose legality is proposed here, consumers do make that determination. The decision whether to employ increased sales effort, offer more post-sale service, and so forth, is the same as the decision whether to incur any other costs. The company or group of

this contention may be tested by the public's recent experience with trading stamps. Certainly for a time it was good business to add trading stamps as an incentive to volume. After a time, however, when all parties had added trading stamps, their addition only increased prices. This is an example of the consequences of following consumer preferences. The food industry was saddled with an added cost which neither the sellers nor the buyers wanted. Luckily the addition of trading stamps did not change the basic structure of the retail distribution system, and when it became clear that the stamps were losing effectiveness, they could be dropped. This could not be done, however, if instead of trading stamps, vertical integration, national advertising, and product differentiation were used to increase market shares. After such a market had been restructured, it is unlikely that it could be turned into a competitive industry again. Moreover, to argue in support of consumer preferences is to ignore the fact that sellers have a basic interest in fostering such preferences. Sellers do not merely react to what the consumers want, they create wants in the consumers that will benefit the sellers. Thus, if an oligopolistic organization of industry is beneficial to sellers and detrimental to consumers, but can be brought about and protected by vertical integration, national advertising, and product differentiation, then oligopolistic industry can hardly be called consumer preference, for the industry is able to persuade the individual consumer of the mythical superiority of his product.

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cooperating companies will attempt to combine expenditures on supplies, machinery, labor, management, advertising, servicing, etc., to arrive at a final package at a price which will prove most profitable. Profitability depends upon favorable consumer response. In a horizontal case, where a group lawfully employing an ancillary restraint is necessarily faced by competitors, the preference of any significant number of consumers for lower prices instead of sales effort or post-sale service, for example, will evoke a response from some producers. In a vertical case the same thing will occur. Where the manufacturer is a monopolist in a vertical case, it may offer different lines of products to attempt most effectively to comply with the preferences of different segments of the market. One line might rely upon heavy sales effort while another might have primarily a price appeal. Where such diversity is not feasible the preference of the majority of consumers will control. In each of the instances where the legality of an ancillary restraint is proposed, consumer choice is as effective as it would be in the corresponding ownership integration situations. Indeed, where contract integration is involved, an ancillary restraint will often be essential to give consumers a choice. But for the restraint, the free ride and other problems discussed would prevent the contract-integrated system from offering the level of sales effort, servicing and other activities which consumers might prefer (footnotes omitted)." *Id.*

To argue this is to deny that society as a whole has any choices, for if the individual consumer decides to pay for product differentiation, his choice is supreme, even if as a member of a group he should decide, after study and deliberation, that such activity is useless and raises costs for him without a corresponding benefit. Such a result cannot be the intent of the antitrust law. Instead, the logic of this argument reflects the belief that the market is made up completely of informed and fully rational people. If we reject this version of consumer choice as the only guide to economic policy, then we must consider what other methods of organizing industry are available to us.

It is clear that oligopolistically organized industries have some definite advantages for members of industry and some disadvantages for the public. First, an oligopolist will not cut prices even when such prices are above cost, for if he has at least twenty per cent of a market and if he decides to cut prices, his fellow oligopolists will cut prices, too. Under such circumstances it is unlikely that anyone will gain in market penetration. Thus our first oligopolists, all things remaining equal, would by such a cut only lose revenue. This does not mean that prices always remain the same. If demands shift so that the total revenue of the industry would be higher if prices were cut, then the industry may as a body reduce prices.[18] In any case, the price relationship between the oligopolists will remain unchanged. Again, this does not mean that all prices charged by all the oligopolists are the same. Each oligopolist differentiates his product by any means at his disposal. Thus, each product would have its own demand curve which would relate directly to the demand curves of the other oligopolists. Under such circumstances it would not be unusual to see essentially equal products sold at slightly different prices. The desire to product differentiate is the key motivation to oligopolists selling to consumers. Each expenditure in this area, if successful, allows each seller to differentiate his product so that in a sense his product becomes unique. That same expenditure may also shift the aggregate demand for the product. The ultimate success of product differentiation makes the oligopolist the only seller of a "particular" desirable product.

Thus, dollars spent for product differentiation have a dual function. First, such expenditures permit the oligopolist a greater mar-

[18] An example of this shift in demand is the air travel industry. Lower prices have brought greater total revenue. We must assume that prior pricing was correct in maximizing revenue but with the improvement of the product, the decline of the railroads and the increase of discretionary income the demand for air travel increased.

ket penetration and more freedom in pricing. At the same time, these expenditures shift the total demand for the goods toward his industry. Moreover, as products are differentiated, the cost of entry is increased, for the cost now includes dissuading the consumer from adhering to his existing preference.

Under the conditions of oligopoly, then, we can expect large expenditures for product differentiation for the purpose of (1) shifting demand toward the product generally, (2) for the purpose of product differentiation and shifting the existing demand among the various oligopolists, and (3) for the purpose of increasing the costs of entry through the establishment of brand preferences. None of the purposes listed, with the possible exception of shifting total demand, grants any benefit to the consumer. As far as the public is concerned, such expenditures are a complete waste of resources. These expenditures do, however, benefit the oligopolists and the persons actually producing the product differentiation. Even the first purpose—shifting total demand—is a waste unless it is necessary to increase demand to a level required for efficient production or unless the product in some way increases the productivity of the individual using it, *e.g.*, advertising to convince people to use better methods for the protection of their health, education, or training.

Thus we can see that none of the usual benefits of price competition occur and that instead of a proper allocation of resources, we have a misallocation. We can therefore assume that if the only purpose of a merger is to enable the merging firms to be better able to compete as oligopolies, then the courts ought not to approve such a merger. For if the purpose of the merger is to help firms product differentiate more easily in local markets though vertical integration, or more easily to product differentiate by advertising in the national market, then the courts should not, and usually do not, approve a merger. On the other hand, if a merger will produce physical efficiency either in scale or in the distribution of the product, or if the merger will prevent one of the firms from leaving the market, then the merger will be approved.

Thus the *Brown Shoe* case holds that vertical mergers will not be approved, if the major purpose of the merger is to establish oligopolistic competition by raising the scale of entry to so great a magnitude that only national concerns with national advertising can exist. Moreover, this case holds that any viable industry will not be allowed to reorganize itself by merger if the efficiencies to be gained by such a merger do not relate to physical efficiencies but rather to gains, through scale advertising and through raising the cost of entry for possible competitors. Such gains may be

useful to an individual firm, but they are not in any way useful to society in general.

On the other hand, if vertical integration coupled with national advertising is desired by individual consumers and if it is profitable to firms, would not the Court's refusal to permit vertical integration by merger be useless insofar as firms would integrate vertically even without mergers? Certainly it would be useless, if the only saving in a merger were the cost of training personnel and investing capital.

An additional restriction to vertical integration, however, does exist in that the market cannot support a substantial increase in competitive facilities. Assume, for example, that the retail selling of shoes is competitive. Assume further that entry is easy and hence enough, if not more than enough, retail stores exist. Under such circumstances, if Brown Shoe, for example, wishes to open up a substantial number of shoe stores, such stores could operate only at a loss, at least until a significant number of other stores went out of business. This loss to Brown Shoe and to other members of the retail trade, makes it cheaper for Brown Shoe to integrate vertically by merger than for Brown Shoe to open its own stores.[19]

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[19] M. SHUBIK, STRATEGY AND MARKET STRUCTURE 132-34 (1959).

"Up to this point we have avoided discussing the possibility that a multiplicity of pure strategy equilibrium points and mixed strategy equilibria exist in a Cournot game. Actually, the market described in subsection 2.3 is of this type. The equilibrium with the eleven most efficient firms producing is only one of the many equilibria possible. In general, in an n-person symmetric Cournot game, if only k firms can produce at a profit greater than or equal to zero, there will be $n!/[k!(n—k)!]$ pure strategy equilibrium points at which k firms produce and $n—k$ firms are only in being. Even if there are cost differences, there may be equilibria with different and not necessarily the most efficient firms in production. Suppose that in the example given in subsection 2.3 the eleven firms in production were not the eleven most efficient but consisted of the ten most efficient and the twelfth most efficient. This would give an equilibrium position, for if the eleventh most efficient firm (now only a firm-in-being) came into active production there would be twelve firms in the market and all would suffer losses. Hence, given that there are already eleven in active production, it is not motivated to enter. (This holds true for any eleven firms out of the first 106 most efficient; the number 106 is obtained by observing that, as fixed costs are rising by 0.001, if player eleven makes a profit of 0.095 with eleven active players in the market then player number 106 would make a profit of zero.)

This result implies that under oligopolistic competition the equilibrium distribution of resources may depend upon the order of entry of firms as well as upon their relative efficiencies (even without considering asset problems.) A simple example which illustrates this point is the entry of a new gas station into an area which already has

several stations. The new plant may be inherently more efficient than several in active production, but the potential entrant may not enter because the profit to all will become negative. A full treatment requires a dynamic model with ruin possibilities introduced explicitly. These comments also hold for price games.

This equilibrium state with "misallocation of resources" does not take place under the competitive assumptions because the individual entrepreneur uses only the existing market price as his entry criterion, in which case firms may enter, depress the market price, cause losses to many (possibly including themselves), and eventually drive out other firms before establishing equilibrium.

Quantity variation markets may have mixed strategy equilibrium points. Once again we stress that it is hard to give an economic interpretation of such an equilibrium because of the restrictions on the model. The ruling out of costs of entry and exit and asset and other dynamic considerations rids us of much that is important to oligopoly theory. However, in some cases an interpretation in terms of overcapacity can be given.

We may view a mixed strategy equilibrium as a fight carried on by a group of firms which is too large to have all members make a profit simultaneously. In any dynamic model this state will not be stable, for eventually some firms will be driven out of competition. An example of such a game is given here.

Consider two firms with average cost functions $\gamma i = 10 - 2.5q_i + q_i^2$ and a demand function $p = 10 - 2 \Sigma q_i$ for $i = 1, 2$. When we solve the equation system $\delta P_i/\delta q_i = 0$ in which P_i is the profit of player i we obtain $q_i(3q_i + 1) = 0$, if we assume that there is a symmetric equilibrium; negative q_i's are inadmissible, and $q_1 = q_2 = 0$ is not an equilibrium point. This indicates that there is no pure strategy symmetric equilibrium point.

There may be a mixed strategy equilibrium. A result obtained by Karlin[9] shows that a mixed strategy in a game of this form involves only two pure strategies. In general, to solve such a game we have $H_2(q_2) = a_1q_2[\phi\Sigma q_1) - \gamma_2(q_2)] + (1 - a_1)q_2[\phi(\Sigma q_1) - \gamma_2(q_2)]$. $H_2(q_2)$ is the expected payoff of the second player and a_1 and $1 - a_1$ represent the probabilities played by the first player we have the conditions

$$H(q_2) = 0,[10] \qquad \frac{\delta H}{\delta q_2} = 0, \qquad q_1 = q_2.$$

In the foregoing example we obtain $a_1 = \frac{1}{8}$. Hence the producer produces $\frac{1}{4}$ with probability $\frac{1}{8}$ or stays out of the market with probability $\frac{7}{8}$. We check this by evaluating the mixed strategy which gives

$$\frac{1}{4}\left[\frac{(1)}{8}\,\frac{(-7)}{16} + \frac{(7)}{8}\,\frac{(1)}{16}\right] = 0.$$

The game has two nonsymmetric pure strategy equilibrium points at $q_1 = \frac{1}{8}$ and $q_2 = 0$ or $q_1 = 0$ and $q_2 = \frac{1}{8}$, respectively (these are obtained by solving the first set of equations without assuming that $q_1 = q_2$ at equilibrium.)

The pure strategy equilibria have only one firm entering the market, whereas the other remains as a firm-in-being. The mixed strategy has both firms active in a market that is "too thin" for two producers of the size (footnotes omitted)." *Id.*

Even when the merger of Brown Shoe with Kinney was denied, Brown Shoe did not attempt to open new stores. Instead it organized a franchise system to accomplish the vertical integration which had been blocked by the Supreme Court's refusal to approve its merger with Kinney.[20] The franchise system also avoided new unproductive investments in retail stores.

This analysis of the *Brown Shoe* case explains why firms use both vertical and conglomerate mergers instead of establishing new firms. Normally, no anti-competitive effect occurs in a conglomerate merger, because separate markets exist for each product. Thus, no difference should exist between a rich man entering an industry by purchasing an existing competitior or a business firm doing so through the use of its capital. In fact, barring firms in one industry from purchasing firms in other industries would cut off important sources of capital. We must not forget, however, that section seven[21] does not apply to new enterprises, and even the complete elimination of conglomerate mergers would not prevent business firms from entering any industry in which more than normal profits were available.

Let us return to the merger situation. Again we must examine why firms merge instead of making new investments. Assume that the industry in which the merger takes place was already oligopolistic. When a firm buys into an industry, it does not disrupt prices and it does not interrupt the existing oligopolistic structure of the industry. On the other hand, starting a new business would impose costs on the entrant and would also cause the whole industry to operate at a price lower than the industry's marginal revenue. For we must assume that prior to the new entry, the firms had been operating so that price equalled marginal revenue. A new entry would be more beneficial to the public than an entry by merger in any industry which had greater than competitive profits or less than optimum investment. Nevertheless, an entry by conglomerate merger into such an industry does no harm and can only be thought of in the same manner as an entry through purchase by anyone into that industry. On the other hand, little societal benefit to a conglomerate merger exists if, by definition, conglomerate involves merging firms which are in different industries.[22]

In addition to the desire to purchase a firm in a profitable industry, conglomerate mergers occur for tax reasons, for empire

[20] *Id.*

[21] Clayton Act § 7, 15 U.S.C. § 18 (1964).

[22] Burck, *The Perils of the Multi-Market Corporation*, FORTUNE, Feb. 1966, at 130.

building purposes, for the purpose of permitting existing personnel to exercise greater management scope, for the purpose of pooling financial resources, and for the purpose of fostering reciprocal buying. Mergers motivated by tax considerations must be dealt with within tax laws, but the existence of tax advantages cannot be taken to excuse possible anti-competitive mergers. Mergers motivated by empire building or by a desire to use personnel may be better studied by psychologists than by lawyers; yet, again, such desires cannot be fulfilled at the expense of a competitive economy. On the other hand, reciprocal trading and financial diversification do have direct impact on the competitive market structure and must be either accepted or rejected as a justification for merger. Reciprocal trading would not be possible in an industry where consumers are the purchasers. In non-consumer industries, the members of the industry cannot product differentiate through sales effort and national advertising.

Is it possible that reciprocal trading may accomplish the same objective in non-consumer industries as product differentiation accomplishes in consumer industries? Reciprocal trading may be able to raise the cost of entry into the industry and so permit existing firms some freedom from competitive pressures. The Court was faced with this problem in *FTC v. Consolidated Foods Corp.*[23] Under orthodox economic analysis, it would not pay Consolidated to force its food processors to buy from its subsidiary, Gentry. It is unlikely, however, that Consolidated would actually pay higher prices when enforcing reciprocal trading. The orthodox argument would assume that if the seller to Consolidated would purchase from Gentry only under pressure, that pressure would be worth something. Thus Consolidated could obtain a further price concession instead of exercising this pressure, and since there is no reason to have Gentry instead of Consolidated make profits, then there would be no reason for Consolidated to exercise the pressure. This argument also assumes that Consolidated is paying the lowest possible price for goods that it buys, and, therefore, cannot exert any pressure unless it pays a higher price for such goods.

Clearly, under realistic market conditions, this analysis breaks down, for it is possible that Consolidated is not getting the lowest price on its purchases. This may occur either because the sellers are unable to cut prices to Consolidated under the anti-price discrimination provisions of the Robinson-Patman Act[24] or because the sellers themselves are not competing in price. Under either circumstance, the seller would be more willing to agree to purchase

[23] 380 U.S. 592 (1965).

[24] 15 U.S.C. § 13 (1964).

from Gentry than to price discriminate in favor of Consolidated. One could say that such practices as price discrimination in favor of large customers are not necessarily bad even though they are outlawed by the Robinson-Patman Act.[25] Such practices have, however, the important side effect of limiting entry into the dehydrated onion and garlic market. Undoubtedly the dehydrated onion and garlic market has an inelastic demand curve because the price of onions and garlic would not substantially effect the price of the food products using onions and garlic. We could conclude, therefore, that a lowered price for onions and garlic would not substantially increase the use of onions and garlic. In such markets, it is important to the sellers that prices are maintained, since price cutting would not benefit anyone but the buyers. Under such circumstances, the more barriers to entry, the better. Entry would be deterred if the possible customers were already taken. A new entrant could only cut prices to its own detriment, since such price cuts would be met. Improving quality is the only possible competitive play. Such a play is not available, however, to the new entrant, because he lacks experience. Accordingly, entry would be forestalled. We can see, then, that conglomerate mergers with reciprocal buying may be used whenever the major partner in the merger is an oligopolistic buyer. The buyer may exert price concessions through reciprocal buying when such price concessions are either not forthcoming because of the oligopolistic nature of the sellers or because of the Robinson-Patman Act. The evil of such mergers does not lie in their cause, however. The evil lies in discouraging entry into an industry.

The other major reason for conglomerate merger, the pooling of financial resources, may have beneficial effects. This is especially true when one of the firms is a failing firm. On the other hand, if the purpose of the merger is to give a firm in a small industry unlimited financial resources, such a merger may have unfortunate market effects, for it is axiomatic that greater financial resources are better than smaller financial resources. Let us then assume an oligopolistic market with a small number of sellers. In such a market, no seller will cut prices, since the price cut would be matched, and the whole industry would receive less revenue. This course of action would not hold true if the other firms could not continuously match the price cut or could not match it over any long period of time. Under such circumstances, the richest firm could expand its share of the market either by price cuts or by threats of price cuts. Other firms would be forced out of the industry or would voluntarily concede some of their share of the mar-

[25] *Id.*

ket to the richest firm. Because of this possibility, the law should take an interest when an industrial giant brings its financial resources into play on a small industry. Where one firm by merger with an industrial giant has financial resources infinitely greater than all the other firms combined and more financial resources than any firm in such an industry could be expected to attract, it would be exceptional indeed if such a firm's market penetration did not increase considerably.[26] This, of course, happened in *Reynolds Metal Co. v. FTC*.[27] The court ordered Reynolds to divest itself of the acquired company but not of the plant built for the acquired company. In the florist foil market, which is the market in the Reynold's case, one of the firms had substantially better financial position than the other firms. Such a firm would never be threatened with price cutting by other firms. The firm also could engage in substantial price cutting knowing that the other firms would not be able to retaliate effectively. Thus the merged firm, if not restrained by other considerations, could impose any conditions of market division that it wished. What it would do, of course, would depend upon what Reynolds hoped to impose as a long run equilibrium. It might be that Reynolds' strategy was to obtain fifty per cent of the market and then to maintain that percentage. At that point, Reynolds could again raise prices and be assured that because of its effective threat of retaliation, no one would attempt to cut into its percentage. The court of appeals ordered Reynolds to divest itself of Arrow.

Nevertheless, the court of appeals did not require Reynolds to dispose of the plant it had built after the merger for Arrow. Thus the court held true to its statement that it would not prevent an industrial giant from entering by new investment an industry populated by commercial pygmies. Such an entry by new investment, of course, is more expensive for the large firm and requires that firm to spend a considerable amount of money before it can achieve a dominant position. To prevent entry entirely would of course cut off nearly all new competition from most industries and leave existing competitors without any check. In addition, the court realized that no law now exists that can prevent entry by new investment.

The other so-called conglomerate merger cases, such as *Continental Can v. United States*,[28] are not in reality conglomerate merger cases at all. In this situation, the Supreme Court recog-

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[26] M. SHUBIK, STRATEGY AND MARKET STRUCTURE ch. 10 (1959).

[27] 309 F.2d 223 (D.C. Cir. 1962).

[28] 378 U.S. 441 (1964).

nized that there is horizontal competition between glass and metal container manufacturers, and, therefore, the Court applied its rather stringent horizontal merger rules to such mergers.

The vertical integration and conglomerate merger cases are based on the theory that the number of possible outlets for a product is relatively fixed and that entry into any industry may be too costly to be economically feasible. These cases, therefore, assume that the number of existing outlets is relatively fixed and that each outlet is a protected market. The Court does not consider whether the protection for the market is great or small. But the Court does recognize that within some range the ability to control the buying habits of existing outlets is a valuable asset. The Court also recognizes that the ability to exclude other firms from existing outlets will add costs to such firms.

If the rationale for the vertical and conglomerate merger decisions is to prevent firms from foreclosing the existing market by raising the scale of entry through vertical integration, outlet foreclosure, and product differentiation, then such decisions would be ineffective if other methods of accomplishing the same purpose were permitted. In industries dealing with consumers, the same effect as a vertical merger can be accomplished by exclusive franchises. The development of such arrangements came about because of the need to combine national advertising with local sales effort and, in some cases, post sales service.

If money is to be spent on advertising, the manufacturer wants to be sure that the retailer does not shift the customer to another product. He also wants to have his products advertised locally and sold by a dealer that has a good reputation in the community.[29] Because the manufacturer believes that he must have an exclusive outlet, he must produce enough volume so that the outlet operates efficiently.

Thus the same problem arises in franchises as arises in vertical integration. The scale of entry is raised to a level that will support only a limited number of companies. If each manufacturer is to have exclusive outlets and the outlets are to be of efficient size and density to give good customer service, then national advertising must insure that each outlet has enough business volume. It is inconceivable that more than three or four heavy truck outlets could be supported by small towns of 10,000 to 100,000 people. If each outlet had to be exclusive, then the number of truck manufacturers would be restricted to four. Such a system makes entry

[29] Bork, *The Rule of Reason: Ancillary Restraints and the Per Se Rule*, 75 YALE L. J. 373, 454-55 (1966).

almost impossible, because the scale of entry would include a volume necessary to support exclusive outlets in every town in America. Thus the franchise system itself has decreed that truck manufacturing be oligopolistically organized. This same analysis can be applied to most fields where the investment in an outlet is substantial and the market will support only a limited number of outlets.

Hence the other restrictions imposed in exclusive franchise arrangements, such as exclusive territories, price fixing and customer allocation, are secondary to the basic evil of exclusive outlet. All other mechanisms make the outlet more secure and allow a greater density of outlets. Once the use of exclusive outlets is accepted as the main method of distributing a product, the other mechanisms probably can do no harm and, in fact, make may entry easier. Let us assume that most of the products of an industry are distributed through exclusive outlets. A new entrant or a smaller existing firm may want to compete through product differentiation. Since the firm must compete through product differentiation and local sales efforts in exclusive outlets, then the firm's only choice is to persuade businessmen to invest in such an exclusive outlet. The firm may be required to guarantee the businessmen exclusive territory in order to persuade them to make the necessary investment. Granting exclusive territories would be unnnecessary, of course, if the producer had a product that was already accepted. Under such conditions, one would be glad to make the necessary expenditure in order to get the franchise. In any case, it would be unfortunate if smaller firms were denied the right to make exclusive territorial franchise arrangements in any industry where the dominant distribution system was through exclusive outlets.

The same reasoning that would permit smaller firms to have exclusive territorial arrangements can also justify such arrangements in new industries. If a new industry calls for the investment of capital and time, then exclusive territorial arrangements with customer allocation may be permitted in order to draw the necessary capital into a new enterprise. That the retail dealer can demand to be the exclusive outlet in an area for a product does not justify, however, the opposite restriction, *i.e.*, that he, as a retailer, deal only in such goods. Such restrictions are not valid and will force the producer segment of an industry into an oligopoly. The only excuse for such a restriction is to induce producers to invest in the capitalization of the retail or service outlets in an untried field. If such investment is necessary to insure that the field be developed, and if the investment would not be forthcoming with-

out such exclusive arrangements, then exclusive arrangements might be allowed for a limited period of time.

The desire of the Court to foster new investment in gasoline stations may have been the rationale behind *FTC v. Sinclair Refining Co.*[30] In that decision, the Court upheld a restriction that gas pumps leased by Sinclair would be used only for the sale of Sinclair gasoline. Of course, all of the major companies were doing the same thing,[31] and the result of the approval of these exclusive arrangements is the oligopolistic marketing system we now have in gasoline. In effect, the Court must decide whether the loaning of capital vertically and the subsequent tie to the retail outlet is justified by the need for capital in the field. In one sense, this sort of ancillary restraint on the loan of capital cannot be outlawed under the merger provisions of the Clayton Act, since the tie involves a new investment. Notwithstanding the *Sinclair* decision, such arrangements are again subject to attack under section five of the Federal Trade Commission Act. The Supreme Court in *FTC v. Brown Shoe*,[32] upheld the determination of the Federal Trade Commission that Brown's insistence that stores push their shoes in return for services was an unfair business practice. Certainly arrangements that provide such exclusive or preferential outlets must be limited in time and be scrutinized carefully to insure that these arrangements do not effectively impose an oligopolistic structure on the market.

The effects arising out of the development of exclusive outlets still plague the courts. The latest problem is found in *Atlantic Ref. Co. v. FTC*.[33] In that case, Atlantic signed a contract with a third party, Goodyear, to supply TBA (tires, batteries, and accessories) to the dealers selling Atlantic's products. As compensation, Atlantic received seven and one-half per cent of gross sales. This payment of compensation to Atlantic shows that an undisturbed access to a substantial market is economically beneficial. Goodyear is basically paying for this undisturbed market. Under standard economic analysis, Goodyear could not pay the additional money to Atlantic and remain competitive with other firms in the sale of tires to dealers. What, then, could explain the ability of Goodyear to pay Atlantic? We must recognize that the sale of TBA in gasoline stations is different from the sale of the same items in a Western Auto and Tire Store, in Sears, or even in a

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[30] 261 U.S. 463 (1923).

[31] FTC v. Maloney Oil & Mfg. Co., 2 F.T.C. 346 (1920).

[32] 384 U.S. 316 (1966).

[33] 381 U.S. 357 (1965).

Goodyear Store. A large number of service station sales are convenience sales, and, therefore, may be made at a higher price. We also recognize that without the sale of the primary product, gasoline, these outlets could not economically exist. The question, then, is who should receive the additional profit that may be obtained from TBA products due to the convenient nature of the outlet? The choice is between the supplier, Atlantic, and the station owner. Atlantic can legitimately believe that the dealer would not have a convenience customer without Atlantic's advertising and good will. On the other hand, the dealer may believe that he is an independent businessman who can build his own TBA business. The fact that Atlantic may force its dealers to purchase products from Atlantic may not concern us as much as the fact that the Atlantic contract with Goodyear forecloses other TBA manufacturers from the convenience TBA market. We know that such contracts will cut off such outlets from other TBA manufacturers. Thus the whole market of convenience TBA will tend to be dominated by the major gasoline distributing companies, either under the private label of the major oil companies or by sales to the major oil companies' dealers through exclusive sales arrangements, such as the Atlantic-Goodyear contract. The result of this arrangement will force the independent TBA manufacturers out of the convenience market. Hence Justice Goldberg is basically correct when he notes that the purchase resale plan carried on by major oil companies has the same foreclosure effect as an exclusive sales agent plan. The only advantage in the repurchase system over the exclusive sales contract system is that smaller manufacturers may exist by selling private labels to the major gasoline companies.

On the other side of the exclusive arrangement is the retailer or agent who wishes to have an exclusive territory. He wishes, of course, to avoid competition with other agents or retailers who sell the manufacturer's goods. If the goods were being sold on the basis of price competition alone, it would be against the manufacturer's interest to allow his agents freedom from competition. The reason for this is obvious. Since there is one price which best moves goods and maximizes revenue, then giving a higher price or protecting the retailer margin would deprive the manufacturer of some revenue. If, for example, he raised his own price to compensate for the higher retail margin, the total revenue would be less, and the manufacturer's total revenue would be even less.

How, then, do we explain the use of exclusive territorial arrangements, resale price maintenance, and customer allocation? It must be explained on the basis that the manufacturer wishes to have his product differentiated by the agent or retailer. If the

manufacturer pays the agent or retailer to make special efforts, the agent or retailer may be able to convince his customers that the manufacturer's product is different, better, and more easily serviced than other products. If the agent or retailer is successful, then the manufacturer's demand curve will have been modified and the total receipts of the retailer and manufacturer will be greater than they would have been without such efforts. This is not to say that their total net receipts would be greater than in an industry where nothing was spent on local sales effort, but only that the receipts are greater for them than their receipts would have been if others were also making a special effort to sell.

The problem of inducements to make special local efforts was presented to the Court in *White Motor Co. v. United States*.[34] The Court refused to rule on the transaction when Justice Douglas said:

> We are asked to extend the holding in Timken Roller Bearing Co. v. United States, supra (which banned horizontal arrangements among competitors to divide territory), to a vertical arrangement by one manufacturer restricting the territory of his distributors or dealers. We intimate no view one way or the other on the legality of such an arrangement, for we believe that the applicable rule of law should be designed after a trial.
>
> This is the first case involving a territorial restriction in a vertical arrangement; and we know too little of the actual impact of both that restriction and the one respecting customers to reach a conclusion on the bare bones of the documentary evidence before us.[35]

The Court was puzzled because the restrictions in question, except for the reservation of customers by White, were for the benefit of the dealers. The Court was faced by an industry which basically sold trucks through exclusive outlets. If White was to compete in this industry, it had to have a successful dealer organization that would give adequate geographic coverage. It was possible that White could acquire this coverage only by granting its dealers a competition-free island, since dealers were required to make large investments and deal solely in White trucks. And, outlawing the arrangement in its entirety might destroy White. The Court did not here discuss the real evil, which is the use of exclusive outlets. If there were general outlets, no need would exist for any of the restrictions, and White would not be forced to grant competition-free islands to be sure that its product was sold and differentiated.

If any successful attack is to be made on the oligopolies in the auto and truck business, it must be made on the exclusive distribution systems themselves. Such an attack may have been made

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[34] 372 U.S. 253 (1963).

[35] *Id.*

in *United States v. General Motors Corp.*[36] In that case, the Court held that General Motors, together with its dealers, could not boycott discounters. That may have been the decision which will permit the growth of multiple outlets and thus make product differentiation more difficult in this field. Clearly, this case must be contrasted with White Motors in that a stricter standard of conduct is expected of General Motors, which is a dominant firm in an industry, than of White Motors, which is a smaller firm in that industry. This is logical because the dominant firm does not need to use exclusive outlets effectively to sell its products, and for all practical purposes, its use of exclusive outlets forces the other firms to use the same method of selling their goods.

Thus the basic structure of the antitrust laws has been modified. The Court no longer limits itself to cases involving monopoly control of industry or horizontal price fixing. Instead, the Court attempts to restrict and, where possible, to prevent the growth and exploitation of the oligopolistic market structures which seem endemic to the American economy. For doing so, the Court has been under continuous attack either for not articulating its policy, for mistakenly attacking vertical integration, or for placing economic theory above business reality. The Court has, however, moved in the only way open to it to stop and, possibly, to reverse the trend toward oligopoly. What the Court has not done is to articulate clearly the reasons for its decisions. These decisions do have an economic basis and carry out a beneficial policy.

This article, then, has articulated the economic basis, as well as the beneficial policy, behind the Court's actions. It has shown that the effect of the Court's decisions is to limit the ability of putative and existing oligopoly firms to product differentiate reciprocally, to purchase or engage in economic warfare for the purpose of excluding new entrants, or to raise the costs of remaining in an industry. If this policy is fully effectuated, it should make new entry easier, and thereby increase the real economic choices of the consumer while limiting economic waste incurred through the creation of product differentiation.

[36] 384 U.S. 127 (1966).